No. 14796.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

H. S. ANDERSON, JR.,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

ETHEL H. ANDERSON,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

ROBERT W. ANDERSON,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

GLORIA S. ANDERSON,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

JOHN HARDY ANDERSON,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeals From the Judgments of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEE.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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BRIEF FOR THE APPELLEE.

Opinion Below.

The District Court's memorandum of decision [R. 59-68] and its findings of fact and conclusions of law [R. 71-92] are reported at 131 F. Supp. 501.

Jurisdiction.

These appeals involve additional federal income taxes and interest paid for the year 1943,[1] which were paid to the Collector of Internal Revenue for the Sixth Collection District of California, at Los Angeles, California, in February and March of 1947. Appropriate claims for refund thereof were timely filed with the Collector of Internal Revenue at Los Angeles on December 28, 1948, which were disallowed by the Commissioner of Internal Revenue by registered notices dated August 29, 1949. [R. 8-9, 15-22, 29-30, 56, 72-73.] Complaints for the recovery of such additional taxes and interest, based on the refund claims disallowed by the Commissioner, were filed in the court below within the time provided in Section 3772 of the Internal Revenue Code of 1939 on August 4, 1950. [R. 3-28, 271.] The suits were brought against the United States, and the court below had jurisdiction of the actions under 28 U. S. C., Section 1346(a)(1).

On March 22, 1955, the District Court entered judgments dismissing the complaints. [R. 92-100.] Notices of appeals were filed on May 20, 1955. [R. 100-105.] The jurisdiction of this Court is invoked under 28 U. S. C., Section 1291.

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[1]Protective claims also were filed by each taxpayer for refund of the full amount of income taxes paid for 1944 on the ground that if the deductions from income for 1942 and 1943 here involved were not allowable, then a net operating loss was sustained in 1944 which could be carried back to 1942 and 1943, and such alternative relief was claimed in the complaints. [R. 14, 22-27, 73-74.] No such issue is presented on these appeals, however. Also, while the payments which gave rise to this controversy were made in 1942 and 1943, and were claimed as deductions for the years in which they were made, only the year 1943 is involved because of the tax foregiveness provisions of Section 6 of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126.

Question Presented.

Whether the court below erred, under the facts and the law, in holding that the taxpayers were not entitled to deduct from their gross income for 1942 and 1943, for federal income tax purposes, either as an amortization allowance deductible under Section 23(l) of the Internal Revenue Code of 1939 or as ordinary and necessary business expenses deductible under Section 23(a) thereof, amounts paid by them respectively in acquiring the interest of the estate of H. S. Anderson, Sr., deceased, in two businesses conducted by H. S. Anderson, Sr., and one or more of the taxpayers, in partnership, prior to his death on December 27, 1941.

Statutes Involved.

The pertinent statutory provisions are set forth in the Appendix, *infra.*

Statement.

These appeals were taken by five individuals from judgments of the court below [R. 92-100], all of which are based on the same facts and involve the same issues of law. The court below made extensive findings of fact [R. 72-90], and by agreement of the parties [R. 271] the record on appeal in the case of *H. S. Anderson, Jr. v. United States* may be considered as the record in the other cases for purposes of this appeal. The material facts found by the court below [R. 71-92], while they relate primarily to the appeal of H. S. Anderson, Jr., may be summarized for present purposes as follows:

Three of the appellants, H. S. Anderson, Jr., Robert W. Anderson, and John Hardy Anderson, are sons of Harold S. Anderson, Sr., deceased; Ethel H. Anderson is

the wife of H. S. Anderson, Jr., and Gloria S. Anderson is the wife of Robert W. Anderson. [R. 154.]

Harold S. Anderson, Sr., died intestate on December 27, 1941. Prior to the date of his death, he was a member of a partnership (sometimes referred to herein as the California partnership), consisting of himself and his son, H. S. Anderson, Jr., in which H. S. Anderson, Sr., the decedent, owned a 75% interest and H. S. Anderson, Jr., owned a 25% interest. The business of this partnership consisted of subsistence contracting work (feeding and housing defense workers) and was conducted in the States of California and Nevada under the name of "H. S. Anderson." The California partnership was organized on January 1, 1938, by virtue of an oral agreement between the decedent and H. S. Anderson, Jr., which contained no agreement for continuance of the partnership in the event of the death of one of the partners. [R. 74-75.]

Also, prior to the date of his death, Harold S. Anderson, Sr., the decedent, was a member of another partnership (sometimes referred to herein as the Alaska partnership) consisting of himself and his three sons. Harold S. Anderson, Sr., owned a 40% interest in this partnership, while Robert W. Anderson owned a 30% interest, John Hardy Anderson owned a 20% interest, and H. S. Anderson, Jr., owned a 10% interest. This partnership was engaged in similar activities within the Territory of Alaska under the name of "Anderson Brothers Supply Company of Alaska." The Alaska partnership was created August 31, 1940, by the execution of a written partnership agreement. [R. 75; Ex. 1.][2]

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[2]Exhibits introduced at the trial have been transmitted to this Court in original form, and, by agreement of the parties [R. 264, 269-271], most of them, including Exhibit 1, have been omitted from the printed record.

On December 11, 1942, a written agreement [R. 113-126] was entered into between Orien H. Anderson, the widow of Harold S. Anderson, Sr., H. S. Anderson, Jr., as administrator of the estate of H. S. Anderson, Sr., deceased, and H. S. Anderson, Jr., individually, Robert W. Anderson, and John Hardy Anderson, sons by a former marriage, and Orien H. Anderson, as guardian of the person and estate of William Todd Anderson, a minor, whereby the parties made certain declarations and admissions for the purpose of settling certain controversies and differences among them relative to the extent and character of the estate of Harold S. Anderson, Sr., deceased. [R. 75-76.]

The agreement of December 11, 1942, after reciting the death of Harold S. Anderson on December 27, 1941 [R. 113], and the relationship of the decedent and the parties to the agreement [R. 113-114], and stating that it was the purpose and intention of the parties to the agreement to settle certain controversies and differences which had heretofore existed between them relative to the extent and character of the estate of Harold S. Anderson, Sr., deceased, to provide money for the payment of the obligations of the estate, and to expedite distribution of the estate to the decedent's heirs, and declaring the formation and interests in the California and Alaska partnerships to be as stated above [R. 114-117], provided in material part that [R. 77-79, 117-118, 119, 123, 125]:

> 6. H. S. Anderson, Jr., as surviving partner of the California Partnership, in full satisfaction and discharge of all claims of the estate of H. S. Anderson, deceased, and of the heirs of H. S. Anderson, deceased, for and on account of the interest of said H. S. Anderson in his lifetime and that his estate

has acquired since his death in and to the California Partnership, hereby agrees to pay into the estate of H. S. Anderson, deceased, the following sums of money:

(a) The sum of $75,000.00 representing, as the parties hereto agree, the fair market value at date of the death of the decedent, of his interest in said California partnership;

(b) The sum of $228,369.32, representing, as the parties hereto agree, the estate's share of the profits of The California Partnership from date of the death of the decedent, December 27, 1941, to the date of this agreement.

* * * * * * * *

8. H. S. Anderson, Jr., Robert W. Anderson, and John Hardy Anderson, as surviving partners of The Alaska Partnership, in full satisfaction and discharge of all claims of the estate of H. S. Anderson, deceased, and of the heirs of H. S. Anderson, deceased, for and on account of the interest of H. S. Anderson in his lifetime and that his estate has acquired since his death in and to The Alaska Partnership, hereby agree to pay into the estate of H. S. Anderson, deceased, the following sums of money:

(a) The sum of $50,000.00, representing, as the parties hereto agree, the fair market value at date of death of the decedent of his interest in said Alaska Partnership;

(b) The sum of $38,000.00, representing, as the parties hereto agree, the estate's share of the profits of The Alaska Partnership from the date of the death of the decedent, December 27, 1941, to the date of this agreement.

* * * * * * * *

17. All the parties hereto agree that the real property and the improvements thereon, said real property being described as follows:

> Lots 65 and 66, in the Industrial Center Tract, in the County of Los Angeles, State of California, as per map recorded in Book 12, page 101, of Maps, in the office of the County Recorder of said County,

and also the shares of stock of Douglas Oil & Refining Corporation, although in the record name of H. S. Anderson, are in reality the property of The California Partnership, and all parties hereto will join in such proceedings as may be proper, convenient or necessary to effectuate quieting title to that effect.

* * * * * * * *

22. In addition to the property set forth in paragraph 17, hereof, there is also a certain oil lease in Ventura County and certain Puett Starting Gate Company stock which is in the name of H. S. Anderson, deceased, but which is the property of the California co-partnership and which is to be handled as provided for in said paragraph 17.

The above agreement of December 11, 1942, was approved by the Superior Court of the State of California in and for the County of Los Angeles, sitting as a court of probate, on December 22, 1942, by order of court which further found, in material part, as follows [R. 79-81; Ex. 21]:

> That H. S. Anderson, deceased, owned a 75% interest in a California partnership known as H. S. Anderson, also known as H. S. Anderson Co., which interest was separate property.
>
> That H. S. Anderson, Deceased, owned a 40% interest in a partnership known as Anderson Bros.

Supply Co. of Alaska, which interest was community property. * * *

That the value of the estate's interest in the California partnership as of the date of death was $75,000.

That the value of the estate's interest in the Alaska partnership as of the date of death was $50,000.00. * * *

That H. S. Anderson, Jr., as the surviving partner of the California partnership, in full satisfaction and discharge of all claims of the Estate of H. S. Anderson, deceased, and of the heirs of H. S. Anderson, deceased, for and on account of the interest of said H. S. Anderson in his lifetime and that his estate has acquired since his death in and to the California partnership, shall pay into the Estate of H. S. Anderson, deceased, the following sums of money:

(a) The sum of $75,000, representing the fair market value at date of the death of the decedent of his interest in said California partnership. * * *

That said H. S. Anderson, Jr., Robert W. Anderson, and John Hardy Anderson, as surviving partners of the Alaska partnership, in full satisfaction and discharge of all claims of the Estate of H. S. Anderson, deceased, and of the heirs of H. S. Anderson, deceased, for and on account of the interest of H. S. Anderson in his lifetime and that his estate has acquired since his death in and to the Alaska partnership, shall pay into the estate of H. S. Anderson, deceased, the following sums of money:

(a) The sum of $50,000.00, representing the fair market value at date of death of the decedent of his interest in said Alaska partnership. * * *

On December 27, 1941, the only activities of the Alaska partnership consisted of subsistence contract work in connection with the construction of the air base Anchorage, Alaska, pursuant to a contract dated July 24, 1940, the contract and operations thereunder being terminable at the will of the Secretary of War. On the same date the California partnership was engaged under contracts or purchase orders, including (a) operation of the post exchange fountain-grills at Camp San Luis Obispo, California, pursuant to an oral agreement entered into in or about March, 1941, later reduced to writing under date of December 9, 1941, terminable on 30 days' notice by either party; (b) operation of the post exchange fountain-grills at Camp Roberts, California, pursuant to a contract dated June 5, 1941, terminable on 60 days' notice by either party, which contract was canceled by the Camp Roberts Post Exchange on February 1, 1943, due to change in military personnel and policy at the Camp; (c) operation of the in-plant feeding facilities at the California Shipbuilding Yards, Terminal Island, California, pursuant to a contract dated September 2, 1941, terminable on 48 hours' notice by the Shipbuilding Corporation, which was canceled by the Corporation on July 27, 1942; (d) operation of the in-plant feeding facilities at the Douglas Aircraft Plant in Long Beach, California, pursuant to an oral agreement entered into on or about July 1, 1941, which agreement was canceled by Douglas Aircraft Company on November 19, 1942. Also, prior to the death of H. S. Anderson, Sr., the California partnership, and the surviving partner thereafter, received various purchase orders (with certain change orders) from the Defense Plant Corporation, acting by and through Basic Magnesium, Inc., for the carrying on of subsistence work during the construction of the Basic Mag-

nesium Plant near Las Vegas, Nevada. These purchase and change orders were dated on dates ranging from December 8, 1941 to October 23, 1942, and were superseded by settlement and release dated July 1, 1943, and by a new contract of the same date, terminable by either party on 90 days' notice. [R. 81-83; Exs. 9, 10, 11, 12, 13, 14, 15.]

The court below found as a fact that a reasonable estimate of the useful economic life of the above contracts and purchase orders, as determined by an Internal Revenue Agent for the purpose of computing depreciation of physical equipment, was two years from and after December 31, 1941. [R. 83.]

On December 23, 1942, a limited partnership for operation of the Anderson Brothers Supply Company of Alaska was entered into between H. S. Anderson, Jr., Robert W. Anderson, John Hardy Anderson, Ethel Hamilton Anderson, the wife of H. S. Anderson, Jr., and Gloria S. Anderson, the wife of Robert Anderson. The new limited partnership was terminated and dissolved on December 31, 1943, by mutual consent and agreement. [R. 85; Exs. 4, 6, 8.]

The court below further found with respect to this new limited Alaska partnership that there is no evidence in the record of what was distributed on the dissolution of the partnership; that there is no evidence in the record of any sale of the partnership; and that there is no evidence in the record of the value of the partnership as of the date of dissolution and termination of the whole of the partnership or of any particular partner's percentage of interest in either partnership. [R. 85-86.]

Also, on December 23, 1942, H. S. Anderson, Jr., Robert W. Anderson, John Hardy Anderson, Ethel Ham-

ilton Anderson, wife of H. S. Anderson, Jr., and Gloria S. Anderson, wife of Robert W. Anderson, formed a limited partnership known as the H. S. Anderson Company to carry on the business theretofore known as the H. S. Anderson Company and the Anderson Brothers Supply Company of Nevada. This new limited partnership also was terminated and dissolved as of the close of business on December 31, 1943, by mutual consent and agreement. [R. 86; Exs. 3, 5, 7.]

With respect to this latter limited partnership the court below also found that there is no evidence in the record of what was distributed on the dissolution of the partnership; that there is no evidence in the record of any sale of the partnership; that there is no evidence in the record of the value of the partnership as of the date of the dissolution and termination of the whole of the partnership or of any particular partner's percentage of interest in either partnership. [R. 86.]

In the formation of the above new limited partnerships by the agreements of December 23, 1942, the percentages or interests held by the sons in the respective businesses were retained by the sons and the interests of the deceased father were divided among the sons and daughters-in-law who furnished the consideration to buy the interests of the deceased. Thus, of the 75% interest owned by H. S. Anderson, Sr., in the California partnership at the time of his death, one-third was acquired by H. S. Anderson, Jr., and his wife, one-third by Robert W. Anderson and his wife, and one-third by John Hardy Anderson; and the 40% interest owned by H. S. Anderson, Sr., in the Alaska partnership was acquired by the

sons and daughters-in-law in the same proportions.[3] The identities of the above 75% and 40% in the old partnerships were carried over into the new, and carried the same percentages in the new partnerships; and the court below specifically found that "The purchase price was a capital investment *and became the base for each interest in the new partnerships.*" (Italics supplied.) [R. 87-88.]

The partnership returns of the new limited partnership, "H. S. Anderson Co.", for the years 1942 and 1943 showed as deductions the sums of $58,082.52 and $77,-483.28, respectively, each of which figures included the sum of $37,500 representing one-half of the $75,000 required to be paid under the above agreement of December 11, 1942; and the partnership returns of the new limited partnership, "Anderson Brothers Supply Company of Alaska", for the years 1942 and 1943 showed as deductions the sums of $25,000 and $25,000, respectively, paid under the above agreement. [R. 55-56, 83-84; Exs. D and E.] The Commissioner of Internal Revenue determined that those payments were not deductible by the partnerships or by the individual partners thereof, and as a result the appellants paid additional income taxes for 1943 and brought these suits to recover. [R. 18-19, 56.]

The refund claims on which these suits were founded [R. 15-21, 22-27], as well as the prayer of the complaints [R. 12-14], claim deduction of the amounts involved on several alternative grounds, including deductibility as expenses under Section 23(a)(1) or (2) of the Internal Revenue Code of 1939, or that they represented payments

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[3]See the court's tabulations of these figures. [R. 87-88.]

for the above contracts and purchase orders, the cost of which should be amortized under Section 23(l) of the 1939 Code over the useful life of the contracts; or that a loss was similarly suffered in 1944 which would, as a net operating loss, be carried back to prior years and then deducted. [R. 72-73.]

But the court below found as a fact that the taxpayers had failed to show that H. S. Anderson, Jr., had purchased particular assets of the California partnership, "H. S. Anderson Co.", from the estate of H. S. Anderson, Sr., and had failed to show that they had purchased particular assets of the Alaska partnership from the decedent's estate; that whatever contracts were in existence had no substantial value and had as a value only a small percentage of the value of $100,000 contended for by the taxpayers; that the contracts were never set up on the books of the partnership as capital assets and never carried any value on the books; and that at the time of the decedent's death, the balance sheet of the California partnership as properly adjusted indicates that the decedent had an interest in that partnership in excess of $71,000, without the alleged contracts being listed as assets. [R. 84-85.]

The court below also found from the evidence that interests in the respective partnerships were purchased, and not specific assets. The sons and their wives could have purchased the specific contracts if they desired, but did not do so. Had they done so, and paid into the estate $100,000, which they contend is the value of the contracts, they could not have purchased thereafter the interest of the decedent in the California partnership for $75,000 and interest in the Alaska partnership for $40,000, as the partnerships had other assets and had the value that

the taxpayers now contend been placed upon them, they would have had to pay closer to $150,000 for the interest of the decedent in the California partnership alone. [R. 88.]

The court further found from the evidence that the three brothers could have purchased the contracts in issue for cash and thus capitalized the contracts in the partnership, but that was not done. Had such a course been taken, the three sons involved here, who each took 1/6 of the separate property of the father, would have recovered from the estate approximately 1/2 (three times 1/6) of the additional amount paid for the partnership interest. The widow and the fourth son (the minor) would have recovered from the estate one-half the additional amount received for the partnership interest in such method of handling. The three brothers have been represented and were represented in their dealings with the estate by able counsel and the actions of the taxpayers and the brothers and sisters-in-law were taken advisedly and the alternatives above rejected. [R. 89.]

The court further found, also on the evidence, that before and up to the date of his death, the decedent and his partner-sons never treated the contracts as capital items. The acts of the deceased on the taxpayers as partners in the old partnerships have a bearing on their intent and the realities of the situation. [R. 89.]

Finally, the court found, also on the evidence, that the taxpayers had failed to establish that the California partnership had an asset of substantial value at the date of the death of H. S. Anderson, Sr., in what later consisted of a subsistence business at the Basic Magnesium plant at Roysen, Nevada. On the contrary, it pointed out that the evidence indicates very little beyond preliminary nego-

tiations for the carrying on of a subsistence business had been consummated at the time of his death, that all the parties to the matter reconsidered it after the death, and only after being assured by H. S. Anderson, Jr., and his father-in-law, that H. S. Anderson, Jr., and his brothers were willing, and able, in their own right to carry it on, were further purchase orders given to H. S. Anderson. The method of arranging for the subsistence business to be carried on was by purchase orders executed by the contractor alone and not until July 1, 1943, was a binding bilateral contract between H. S. Anderson Company and the contractor entered into, which was a year and a half after the death of H. S. Anderson, Sr., and long after the purchase of the interest of H. S. Anderson, Sr., deceased, from his estate and the formation of a new limited partnership between the sons and sisters-in-law of the sons and wives of the Anderson sons. It found that the contracts have no value, were not purchased and could not be deducted as expenses paid for the production or collection of income, or the management, conservation or maintenance of property held for the production of income, or could not be capitalized and amortized or depreciated or allowed as a loss in either 1943 or 1944. [R. 89-90.]

In accordance with the foregoing findings, the District Court concluded that the taxpayers herein purchased the interests of H. S. Anderson, Sr., deceased, in the two partnerships known as H. S. Anderson Company and Anderson Supply Company of Alaska, and not specific assets or specific contracts, by the payment to the estate of the father of the sums of $75,000 and $40,000 respectively. The court held that the taxpayers failed to sustain their burden of proving their right to a refund of the

taxes sought by them, and that the sums can not be capitalized and depreciated, and that they did not give rise to deductible losses in 1943 or 1944, or loss carrybacks from 1944 to 1943. [R. 91.]

Summary of Argument.

The District Court rightly denied the taxpayers any expenses or amortization deductions under Section 23(a) or (1) of the Internal Revenue Code of 1939 with respect to costs allegedly incurred in purchasing from the estate of H. S. Anderson, Sr., interests in various contracts held by two partnerships in which the decedent was a partner. The taxpayers failed to comply with the settled rule that one seeking a deduction must bring himself squarely within the provisions of a statute.

Apparently their claim to an expense deduction is not seriously pressed since the taxpayers merely point to the statute with no effort to show from the record that they incurred ordinary and necessary expenses deductible thereunder.

The lower court found, in accordance with the evidence, that interests in the two partnerships were purchased from the deceased partner's estate, and not contracts. The unambiguous terms of an arm's-length agreement between the decedent's heirs and one or more of his three sons, who are taxpayers herein, as surviving partner or partners, show clearly that the sums paid the estate represented the fair market value at the date of death of the decedent's interests in the two partnerships and that such sums were paid his estate by the surviving partner or partners to purchase such interests. The California court, sitting in probate, entered an order specifically approving the fair market values placed on the estate's interests in the two partnerships and the agreement for the sale of those

interests to the surviving partner or partners. The record contains no support for the taxpayers' claim that specific partnership assets, consisting of contracts, were purchased from the estate, except for certain self-serving testimony by one of the taxpayers which is flatly contradicted by all of the records of the transaction.

Under California law, the two partnerships of which decedent was a partner were dissolved by his death, but were not terminated, the partnerships continuing until the completion of the winding up of partnership affairs. Disoslution consists merely of a change in the relationship of the partners, so there was no distribution of partnership assets. A deceased partner's right in specific partnership property vests in the surviving partner or partners, who have the right to continue to possess it for partnership purposes. Therefore, the surviving partners who purchased the interests of the decedent's estate in the two partnerships would have been attempting to acquire something already vested in them if, instead, they had purchased specific partnership assets as they contend. Moreover, the estate could not have sold specific partnership assets to which it had no right.

No termination of the subsistence contracting business carried on by either of the two partnerships was contemplated for, prior to the purchase of the estate's interests in them, there was an understanding between the five taxpayers as to sharing the costs of such interests and the formation of the two limited partnerships subsequently formed by them for the continuance of such businesses. The identity of the interests purchased from the estate is readily traceable into the new limited partnerships.

A partner is a co-owner with his partner or partners of specific partnership property. However, his interest in the partnership, which is personal property, is his share of profits and surplus. His property rights consist of (1) his rights in specific property, (2) his interest in the partnership, and (3) his right to participate in management. The record discloses that all of the estate's interests in the two partnerships were purchased and it contains nothing which even suggests that the transaction was limited to specific assets of the partnerships, to which, as we have noted, the estate had no right.

As a further indication that interests in the partnerships were purchased, the record discloses that the contracts held by the two partnerships, which comprise the specific assets allegedly purchased, in fact, had very little value, as the trial court found, and were not of the value of $100,000 as the taxpayers contended. They did not represent binding commitments of sufficiently substantial duration to even begin to support any such valuation. Moreover, the evidence indicates that the partnership interests purchased from the estate reflected substantial tangible partnership assets. No proof was offered of their value or as to the value of the contracts. Therefore, in no event would the taxpayers be entitled to the amortization deductions they seek, as they have not sustained the burden, which is upon them, of proving the amount, if any, which they are entitled to amortize.

The taxpayers' hope of profitably continuing the subsistence contracting businesses of the two partnerships in which the decedent was a partner necessarily arose from the fact that they were acquiring interests in going concerns already engaged in furnishing subsistence services to customers, since the partnerships owned no binding

contracts of very substantial duration. The amounts paid for the estate's interests in the partnerships, to the extent that they exceed the fair market value of tangible partnership assets attributable to those interests, if anything, represented going concern value.

This Court has held that a partnership interest is a capital asset. The cost of acquiring such interest is not recoverable through deductions from gross income but must await the determination of gain or loss upon ultimate disposition of the interest. The District Court was correctly advised as to the controlling principles and properly regarded as distinguishable the Tax Court case relied upon by the taxpayers.

The taxpayers might have purchased specific contracts held by the two partnerships had they so desired. Instead, they purchased partnership interests, and, of course, what was actually done controls.

The District Court fully answered the taxpayers' contention, that they will not be able to recover their costs of acquiring interests in the two partnerships unless they are permitted expense or amortization deductions, when it pointed out that they chose not to consider that they had purchased an interest in each partnership which was a capital asset and introduced no evidence to show the consequences of the termination in December, 1943, of their partnerships.

ARGUMENT.

The District Court Correctly Denied the Taxpayers an Expense Deduction Under Section 23(a) or an Amortization Deduction Under Section 23(l) of the Internal Revenue Code of 1939 for the Years 1942 and 1943 With Respect to Amounts Which the Evidence Showed Were Used to Purchase, From the Decedent's Estate, Interests in Two Partnerships Conducted by the Decedent and One or More of the Taxpayers Prior to the Decedent's Death on December 27, 1941.

These appeals involve the question whether the taxpayers are entitled to deduct from gross income for the years 1942 and 1943 certain amounts expended by them in those years in acquiring the interest of the estate of H. S. Anderson, Sr., in two partnerships of which the decedent was a member at the time of his death. In their claims for refund [R. 15-21, 22-27], as well as in the prayer of their complaints [R. 12-14], the taxpayers claimed the right to deduct such amounts upon several alternative grounds, all of which were rejected by the court below. [R. 59-68.] On these appeals, however, the taxpayers are contending (Br. 10-28) only that such payments are deductible as an amortization allowance under Section 23(l) of the Internal Revenue Code of 1939 (Appx., *infra*), which provides that in computing net income there shall be allowed as a deduction "A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) of property held for the production of income"; or, in the alternative, that such payments are deductible as current expenses during such years under Section 23(a) of the 1939 Code (Appx., *infra*), which provides for the allow-

ance of a deduction for "All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business", and, in the case of an individual, "all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

Since the taxpayers are seeking a deduction, it is important to keep in mind the settled rule that they can entitle themselves thereto only by bringing themselves squarely within the terms of a statute. (*Deputy v. du-Pont,* 308 U. S. 488, 493; *White v. United States,* 305 U. S. 281, 292; *Jones v. Commissioner,* 103 F. 2d 681 (C. A. 9th).) In oft-quoted language the Supreme Court reiterated this principle in the *White* case (p. 292):

> Moreover, every deduction from gross income is allowed as a matter of legislative grace, and "only as there is clear provision therefor can any particular deduction be allowed . . . a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms."

The taxpayers have wholly failed to comply with this precept.

Prior to considering the factual aspects of the case, it is to be noted that the taxpayers' alternative argument (Br. 11-13) that the amounts in issue constitute deductible expenses is not seriously pressed on brief. It is axiomatic that, before they can be allowed an expense deduction under either subdivisions (1) or (2) of Section 23(a), the taxpayers have the burden of showing that they have *incurred expenses* which are both *ordinary* and *necessary. Welch v. Helvering,* 290 U. S. 111;

Deputy v. duPont, supra, pp. 495-496; *Fontana Power Co. v. Commissioner,* 127 F. 2d 193 (C. A. 9th); *City Ice Delivery Co. v. United States,* 176 F. 2d 347, 351 (C. A. 4th), and cases there cited. The taxpayers here have contented themselves with merely citing the provisions of the statute authorizing expense deductions without any effort to demonstrate from the evidence or by reference to the decided authorities that the expenditures in question constituted ordinary and necessary expenses. Their alternative argument is, of course, inconsistent with their principal position (Br. 13-18, 27) that the expenditures in question were for capital items the cost of which is recoverable by way of depreciation or amortization, and they offer nothing, theoretical or otherwise, which would suggest any basis upon which such expenditures could properly be deducted as expenses under the statute.

The fundamental controversy concerning the facts presented to the court below is whether, by the expenditures in question, the taxpayers purchased partnership assets consisting of certain contracts the cost of which was properly recoverable by amortization, as they contended; or whether they purchased a partnership interest, which is a capital asset not subject to depreciation, as the Government claimed. The District Court resolved this issue against the taxpayers, and its disposition of the matter should not be disturbed unless shown to be clearly erroneous. (Rule 52(a), Federal Rules of Civil Procedure; *United States v. Gypsum Co.,* 333 U. S. 364, reh. den., 333 U. S. 869.) It may readily be seen from the instant record, we submit, that the District Court's finding on this issue is firmly grounded in the evidence, and is not clearly erroneous.

The District Court found and concluded [R. 84, 91] that the taxpayers failed to sustain their burden of proving by a preponderance of the evidence that they purchased particular assets from the two partnerships, interests in which were held by the estate of H. S. Anderson. On the contrary, the record is replete with evidence that, as the trial court found [R. 88], "Interests in the respective partnerships were purchased and not specific assets." Thus, an agreement (quoted from at length in the findings below [R. 75-79]), which, after lengthy negotiations, was entered into on December 11, 1942, between the widow of H. S. Anderson, both for herself and as guardian of her minor child, and the three sons of the decedent by a former marriage who are taxpayers herein, indicates unequivocally and precisely just what the taxpayers intended and undertook to purchase by the expenditures the tax consequences of which are the subject of this litigation. Under that agreement the [R. 78] "sum of $75,000.00, representing, as the parties hereto agree, the fair market value at the date of death of the decedent, of his interest in said California partnership" was agreed to be paid [R. 77] "into the estate of H. S. Anderson, deceased" in "full satisfaction and discharge of all claims of the estate * * * and of the heirs * * * *for* and on account of *the interest* of said H. S. Anderson in his lifetime and that his estate has acquired since his death *in* and to *the California Partnership*". (Italics supplied.) Similarly, the parties agreed [R. 78] that the sum of "$50,000.00" was "the fair market value at date of death of the decedent of his interest in said Alaska Partnership" and that payment of this amount be made to the estate "*for* and on account of *the interest* of H. S. Anderson in his lifetime and that his estate has acquired since his death *in* and to *The Alaska Partnership*". (Italics supplied.)

The agreement of December 11, 1942, covering the sale by the estate of H. S. Anderson, Sr., of the interests in the two partnerships, was approved by the Superior Court of the State of California in and for the County of Los Angeles, sitting as a court of probate, on December 22, 1942 [R. 79-81], the court's order specifically providing [R. 80] "That the value of the estate's interest" in the California and Alaska partnerships was "$75,000.00" and "$50,000.00", respectively, just as the parties had agreed.

The record contains nothing whatever which supports the taxpayers' contention that they purchased partnership assets, consisting of specific contracts, rather than partnership interests, save, perhaps, certain self-serving testimony of the taxpayer, H. S. Anderson, Jr., upon which they attempt to rely. (Br. 21-23.) The complete answer to that testimony is that it is flatly contradicted by all of the evidence consisting of the records of the transaction, and, indeed, upon objection, the District Court quite properly declined to permit that witness to testify that the $75,000 paid for the estate's interest in the California partnership was paid to purchase particular contracts, and not a partnership interest upon the ground that the contract speaks for itself and is the best evidence of what the parties purchased. [R. 175.]

The pertinent provisions of the California Civil Code relating to partnerships clearly indicate the various rights and interests existing with respect to the instant partnerships. While the death of H. S. Anderson, Sr., caused a dissolution of the two partnerships in which he was a member (Deering's Cal. Civ. Code, Sec. 2425, Appx., *infra*), that dissolution was not the equivalent of a termination of the partnership business with its at-

tendant distribution of partnership assets. A dissolution consists merely of a change in the relationship of the partners caused by any partner ceasing to be associated in the carrying on, as distinguished from the winding up, of the business (Sec. 2423, Appx., *infra*), and does not terminate the partnership, which continues until the winding up of partnership affairs is completed (Sec. 2424, Appx., *infra.*).

Here, it is clear that the two partnership interests held by the estate of H. S. Anderson, Sr., were, in each instance, purchased by the surviving partners. [R. 77-78, 80-81.] This is significant inasmuch as on the death of a partner, as here, his right in specific partnership property vests in the surviving partner or partners, who have the right to continue to possess the partnership property for partnership purposes. (Deering's Cal. Civ. Code, Sec. 2419(2)(d), Appx., *infra.*) Since the deceased partner's interests in the specific assets of the two partnerships were already vested in them, for the purpose of carrying on the partnership business, the surviving partners would have acquired nothing not already possessed by them by the purchase of specific partnership assets, which belies the suggestion that they purchased assets and not partnership interests, in each instance, from the two partnerships. By the same token, the estate had no right whatever to specific partnership assets and, therefore, would have been unable to sell them prior to their distribution in termination of the partnership.

While the interests in the two partnerships held by the estate of the deceased partner were, in each case, purchased by the surviving partners, it is evident that no termination of the partnership business was contemplated, for, prior to such purchases, an understanding

had been arrived at between the five taxpayers herein with respect to the sharing of the costs of the partnership interests and the formation of the two limited partnerships which, subsequent to the purchase of the partnership interests, and on December 23, 1942, were formed by them for the purposes of continuing to carry on the subsistence contracting business of the California and Alaska partnerships [R. 210-211, Exs. 3 and 4]; and, as the District Court so vividly demonstrated [R. 64-66], the identity of the interests purchased from the estate of the deceased partner were preserved and may readily be followed into the two new limited partnerships.

Although a partner is a co-owner with his partners of specific partnership property holding as a tenant in partnership (Deering's Cal. Civ. Code, Sec. 2419(1), Appx., *infra*), his interest in the partnership is his share of the profits and surplus, and the same is personal property (Sec. 2420, Appx., *infra*). A partner's property rights consist of (1) his rights in specific property, (2) his interest in the partnership, and (3) his right to participate in the management (Sec. 2418, Appx., *infra*), and it is perfectly clear that all, and not just the first, of these rights were the subject of the agreement of December 11, 1942, for the purchase of the two partnership interests. [R. 75-79.]

Consistent with the evidence that *interests* in, and not specific contracts belonging to, the partnerships were purchased in the transactions in question, the District Court found [R. 84] that:

> What ever contracts were in existence at the time of death of the deceased had no substantial value and had as a value only a small percentage of the value of $100,000.00 contended for by plaintiffs.

This ultimate finding by the court is fully supported by its evidentiary findings, not questioned here, which disclose that the two partnerships had no contracts binding for any substantial period of time. On the contrary, the contract under which the activities of the Alaska partnership were conducted was terminable at the will of the Secretary of War. As to the California partnership, the longest contract which it had, namely, that relating to the operation of the post exchange fountain-grills at Camp Roberts, California, was terminable on 60 days' notice by either party; the contract for the operation of the post exchange fountain-grills at Camp San Luis Obispo, California, was similarly terminable on 30 days' notice; the contract with the California Shipbuilding Yards, Terminal Island, California, was terminable on 48 hours' notice; and there was no written contract covering the activities of the partnership at the Douglas Aircraft Plant in Long Beach, California. [R. 81-82.] The subsistence work carried on by the California partnership during the construction of the Basic Magnesium plant at Roysen, Nevada, was carried on entirely under purchase orders until July 1, 1943, at which time the first binding bilateral contract between the parties was executed. Only a few such purchase orders had been secured by the partnership prior to December 27, 1941, the date of the deceased partner's death. [R. 82-83, 89-90.] It is clear that these comprise no binding commitment of any real substance insofar as the subsistence work at the Basic Magnesium plant is concerned, since shortly after the death of the deceased partner it became necessary for the other partner, H. S. Anderson, Jr., to return to Nevada in order, as he testified [R. 162], "to attempt to resell McNeil Construction Company, and the Defense Plant Corporation on our ability to continue

on." Insofar as the Basic Magnesium plant operation was concerned, as the District Court observed [R. 90], "very little beyond preliminary negotiations for the carrying on of a subsistence business had been consummated" at the time of the death of H. S. Anderson, Sr.

In addition to the fact that the contracts held by the two partnerships lack any such value as the taxpayers seek to attribute to them, the record discloses, contrary to their contention (Br. 21), that the interests of the decedent in the two partnerships reflected substantial tangible partnership assets. This appears from the adjusted balance sheet of the California partnership [R. 129, Ex. A], the adjustments to which were made by a revenue agent and consist of a substantial increase in the value of the net assets due to the restoration of certain equipment which had been charged to expense. [R. 110-111.] As the District Court noted [R. 63], "No proof whatever was offered on the value of the contracts assets at the time of the death of deceased or on December 11, 1942, or *what was the value of other assets*[4] if the contracts had a value." (Italics supplied.) Therefore, even if it could be concluded from the evidence as a whole

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[4]The adjusted balance sheet of the California partnership [R. 129] discloses that the decedent's interest therein had an asset value of over $71,500 and the District Court referred to this adjusted book value of the decedent's interest [R. 63, 85] as not including the contracts held by the partnership which were not listed as capital assets. Assuming, without conceding, that the $71,500 included an advance of $29,013.26 to the partnership by H. S. Anderson, Jr., which was paid back to his estate in addition to the $75,000 paid for the partnership interest, as the taxpayers contend (Br. 26), that fact would be of no real significance. It is none the less incontestably clear that there were substantial tangible assets and the fair market value, not the book value, would necessarily be the governing factor as to what portion, if any, of the $75,000 purchase price of the partnership interest related to tangible partnership property.

that the taxpayers acquired assets rather than the interests of the decedent's estate in the California and Alaska partnerships, it is clear that they failed to sustain their burden of proving facts essential to any recovery by them. This Court has held that a taxpayer seeking a depletion deduction (which, we submit, is comparable, for this purpose, to the amortization deduction sought here) has the burden of proving the exact amount of the deduction to which he is entitled. *Lamm Lumber Co. v. Commissioner,* 133 F. 2d 433, 434. Moreover, the decisions relating to the amortization of contracts make it quite clear that as a prerequisite to the allowance of such amortization, the taxpayer must prove value—that is, the basis attributable to the contracts for the purpose of computing depreciation—and must show that they are for a definite and limited period.[5] *Hopkins v. United States,* 82 F. Supp. 1015 (Ct. Cls.); *Cook China Co. v. Commissioner,* 1 B. T. A. 254; *William Morris Enterprises, Inc. v. Commissioner,* 1 B. T. A. 946, 951-952. This the taxpayers here have failed to do.

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[5]An Internal Revenue Agent, for the purpose of computing depreciation of physical equipment, estimated the useful life of all the various contracts and purchase orders held by the two partnerships in which the estate held interests at two years from December 31, 1941. [R. 55.] Consistent with this, the Government conceded that if the District Court determined that valuable contracts were purchased by the taxpayers, of a kind which could properly be depreciated over a period of time, then the years 1942 and 1943 would constitute the period over which they should be depreciated. [R. 139-140.] It is important to note that the arbitrary assignment of a two-year life to the contracts purely for convenience in the computation of depreciation on physical equipment was governed by different considerations and has no significance with respect to the totally different problem of examining each contract in connection with its evaluation, to determine whether it represented a binding commitment of any substantial duration.

Since, as we have observed, the two partnerships had no contracts containing binding commitments of any substantial duration, it is apparent that such expectations as the taxpayers may have entertained when they acquired the interests of the deceased partner's estate of profitably continuing the partnerships' subsistence businesses lay in the fact that they were buying into going concerns which were already on the ground, furnishing subsistence services to their customers, or with operations in progress, and were not a consequence of any contracts owned by the partnerships. The District Court was correct, therefore, in taking the view that the amounts by which the purchase prices paid for the two partnership interests by the surviving partners exceeded the value of the partnership shares which those interests represented in the tangible assets of the partnerships [R. 85], "if anything * * * [represented] good will or going concern value."[6]

The evidence establishes, as has been demonstrated above, that the surviving partners undertook to purchase the deceased partner's interests from his estate. As the Supreme Court said in *Bull v. United States,* 295 U. S. 247, 254:

> Where the effect of the contract is that the deceased partner's estate shall leave his interest in the business and the surviving partners shall acquire it by payments to the estate, the transaction is a sale, and

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[6]Perfectly consistent with this is the District Court's remark [R. 261], relied upon by the taxpayers (Br. 23-24), that "it would be fair to make a finding that the Anderson Brothers would not have paid the $125,000" for the two partnership interests "if it had not been for the subsistence deals then existing" at San Luis Obispo, Camp Roberts, Basic Magnesium, Douglas Aircraft, and California Shipbuilding.

payments made to the estate are for the account of the survivors.

It is settled by the decisions of this Court that a partnership interest constitutes a capital asset upon which the determination of gain or loss must await the ultimate disposition of such interest. *Stilgenbaur v. United States,* 115 F. 2d 283; *Commissioner v. Estate of Gartling,* 170 F. 2d 73, affirming *per curiam* Tax Court decision of July 28, 1947 (1947 P-H T. C. Memorandum Decisions, par. 47,213); *Hatch's Estate v. Commissioner,* 198 F. 2d 26; *United States v. Snow,* 223 F. 2d 103, certiorari denied, 350 U. S. 831. And, expenditures for the acquisition of partnership interests are not subject to recovery by way of deductions from gross income. *Cf. Brown v. Commissioner,* 63 F. 2d 66 (C. A. 9th), affirmed on other grounds, 291 U. S. 193; *Edwards v. Commissioner,* 102 F. 2d 757, 759 (C. A. 10th); *Autenreith v. Commissioner,* 115 F. 2d 856, 858 (C. A. 3d); *Hill v. Commissioner,* 38 F. 2d 165, 168 (C. A. 1st), certiorari denied, 281 U. S. 761; *Kenworthy v. Commissioner,* 197 F. 2d 525 (C. A. 3d); *Watson v. Commissioner,* 82 F. 2d 345 (C. A. 7th).

The District Court correctly concluded that its disposition of this case must be controlled by the principles laid down by this Court in the *Stilgenbaur* case, *supra,* and similar decisions in *Commissioner v. Shapiro,* 125 F. 2d 532 (C. A. 6th), and *Thornley v. Commissioner,* 147 F. 2d 416 (C. A. 3d). [R. 66.] It rejected the case of *Blum v. Commissioner,* 5 T. C. 702, relied upon by the taxpayers (Br. 13-16), as not applicable to the facts in the present case, without expressing any opinion as to the correctness of the holding there. [R. 62-63.] The court's action in so doing was quite proper. The

Blum case involved a sale by one of two partners of his interests, including his interest in all the partnership assets, to the other, who thereafter conducted the business as a sole proprietorship. The assets of the sole proprietorship he, of course, owned in his own right, in contrast with a partner's interest in partnership assets, and, as the sole proprietor, he disposed of assets which he had acquired. This presented the problem of determining his basis of such assets for the purpose of the computation of the amount of income or gain or loss, as the case might be, resulting from these transactions. These features distinguish the *Blum* case from the one at bar, where the assets of the business continued to be partnership assets throughout, owing to the absence of any termination of the partnership business.

This Court has held that it is what was done and not what might have been done which controls. *Stilgenbaur v. United States,* 115 F. 2d 283, 286-287. These taxpayers, as the lower court pointed out [R. 66-67], might have purchased the specific contracts held by the two partnerships had they so desired. The undeniable fact remains, however, that they purchased partnership interests instead. The District Court observed that [R. 67-68]:

> Plaintiffs have been represented here and in their dealings with the estate by able counsel. We conclude the actions of plaintiffs were taken advisedly and the alternatives above rejected.

Finally, the taxpayers' position is premised on one obvious fallacy. It is repeatedly suggested (Br. 10, 13-18) that if they are not entitled to recover their costs of the estate's interests in the California and Alaska partnerships by way of amortization deductions, they will be denied all right to recover such investments tax

free. But this argument is best answered by the District Court. The record discloses that the new limited partnerships in which the taxpayers were partners were terminated and dissolved on December 31, 1943. [R. 85-86.] However, the taxpayers have studiously avoided any claim to the benefit of the provisions relating to the determination of capital gains and losses. There was a complete absence of any evidence which would indicate whether the taxpayers realized a gain or loss upon the ultimate disposition of their investment in the two partnership interests purchased from the estate, as the trial court pointed out [R. 64]:

> There was no dispute that the new partnerships were cancelled at the end of 1943. But there was no evidence of what was distributed on their dissolution or of any sale of the partnership or of the value as of that date of the whole of each partnership or of any particular per cent in either one. The Court cannot say what the value of the 75% and the 40% interests in the two partnerships were as of December 31, 1943. This would have been susceptible of proof. But plaintiffs chose not to consider that they had purchased an interest in each partnership which was a capital asset.

It is respectfully submitted that the District Court's findings that partnership interests were purchased from the estate of decedent, and not specific partnership assets, is amply warranted by the record and that the court correctly denied the taxpayers any deduction as expenses for amortization on account of the expenditures made by them in that connection.

Conclusion.

The District Court's judgments are correct and should therefore be affirmed.

Respectfully submitted,

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APPENDIX.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

(a) [As amended by Sec. 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * * * * *

(l) [As amended by Sec. 121(c) of the Revenue Act of 1942, *supra*] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

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(26 U.S.C. 1952 ed., Sec. 23.)

Deering's California Civil Code (1941 ed.):

SEC. 2418. *Extent of property rights of a partner.* The property rights of a partner are (1) his rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management.

SEC. 2419. *Nature of a partner's right in specific partnership property.* (1) A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

(2) *The incidents of this tenancy* are such that:

* * * * * * * *

(d) [*Survivorship*] On the death of a partner his right in specific partnership property vests in the surviving partner or partners, except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners, or the legal representative of the last surviving partner, has no right to possess the partnership property for any but a partnership purpose.

* * * * * * * *

SEC. 2420. *Nature of partner's interest in the partnership.* A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.

SEC. 2423. *Dissolution [Defined].* The dissolution of a partnership is a change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business.

SEC. 2424. *Partnership not terminated by dissolution.* On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed.

SEC. 2425. *Causes of dissolution.*—Dissolution is caused:

* * * * * * * *

(4) By the death of any partner;

* * * * * * * *

SEC. 2431. *Right to wind up.* Unless otherwise agreed the partners who have not wrongfully dissolved the partnership or the legal representative of the last surviving partner, not bankrupt, has the right to wind up the partnership affairs; provided, however, that any partner, his legal representative, or his assignee, upon cause shown, may obtain winding up by the court.

SEC. 2436. *Rights of retiring or estate of deceased partner when the business is continued.* When any partner retires or dies, and the business is continued under any of the conditions set forth in Section 2435 (1, 2, 3, 5, 6), or Section 2432 (2b) without any settlement of accounts as between him or his estate and the person or partnership continuing the business, unless otherwise agreed, he or his legal representative as against such persons or partnership may have the value of his interest at the date of dis-

solution ascertained, and shall receive as an ordinary creditor an amount equal to the value of his interest in the dissolved partnership with interest, or, at his option or at the option of his legal representative, in lieu of interest, the profits attributable to the use of his right in the property of the dissolved partnership; provided, that the creditors of the dissolved partnership as against the separate creditors, or the representative of the retired or deceased partner, shall have priority on any claim arising under this section, as provided by Section 2435(8) of this code.